

Chutes and Ladders in Dairy

A few more ladders than chutes

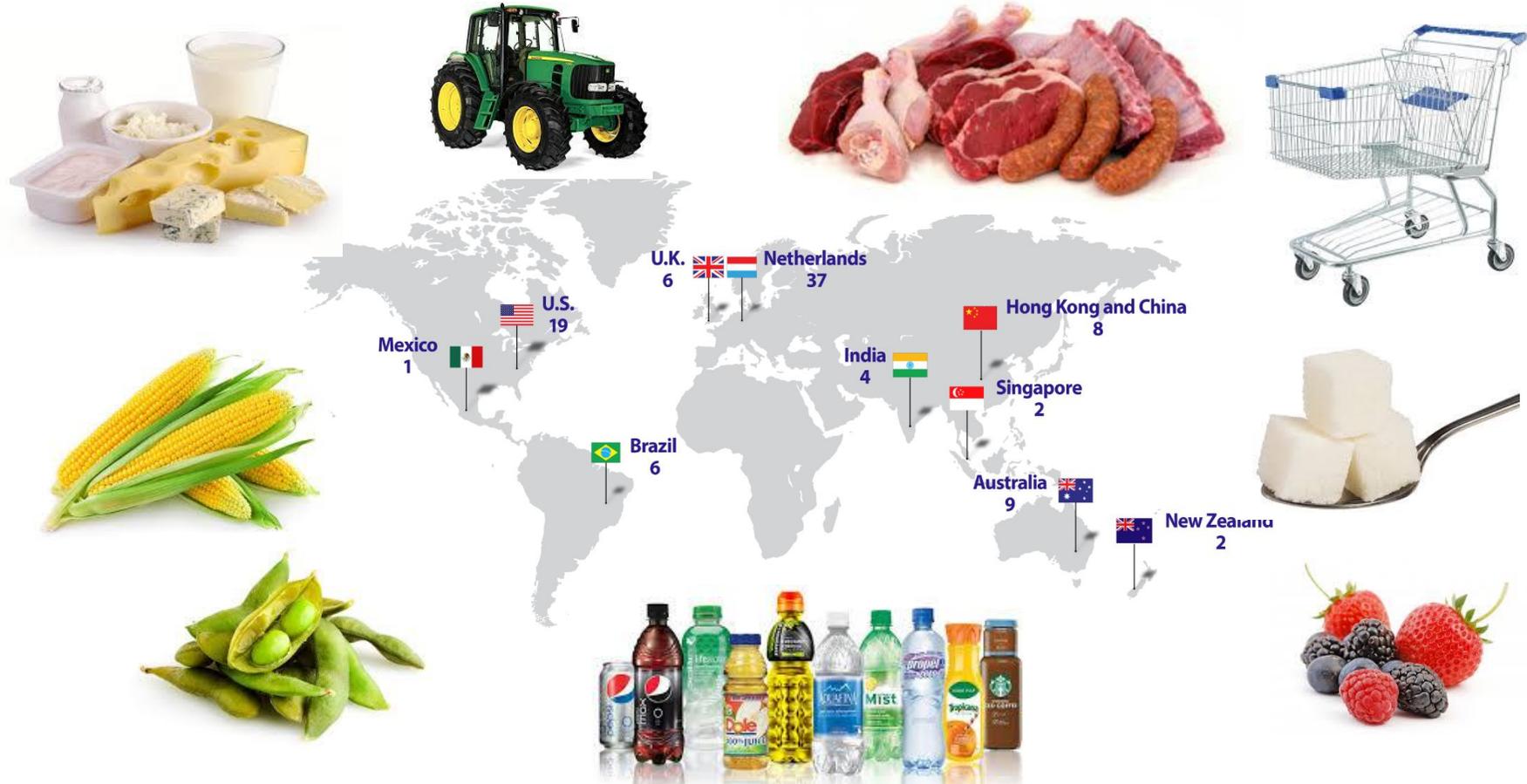
October 2016



Rabobank

Food & Agribusiness Research and Advisory

Rabobank's unique global team of 94 analysts – supporting knowledge based banking



Upfront summary



The global dairy market faces more upside in months to come, but there are some chutes.

Six out of seven major dairy exporting regions currently have milk supply contracting.

Global exportable surplus is now tighter than any time since 2009.

Intl dairy prices have responded accordingly with 35% increases in prices.

Production will be slow to respond to higher prices.

Intl prices will have upward pressure for months to come.

But, US butter and cheese prices have some headwinds due to inventories.

Global inventories are also very weighty on prices, but less of a concern.

The strong USD will affect affordability in already struggling oil dependent markets.

Section 1

Current market status

Section 2

Downward pressure on prices – ‘chutes’

Section 4

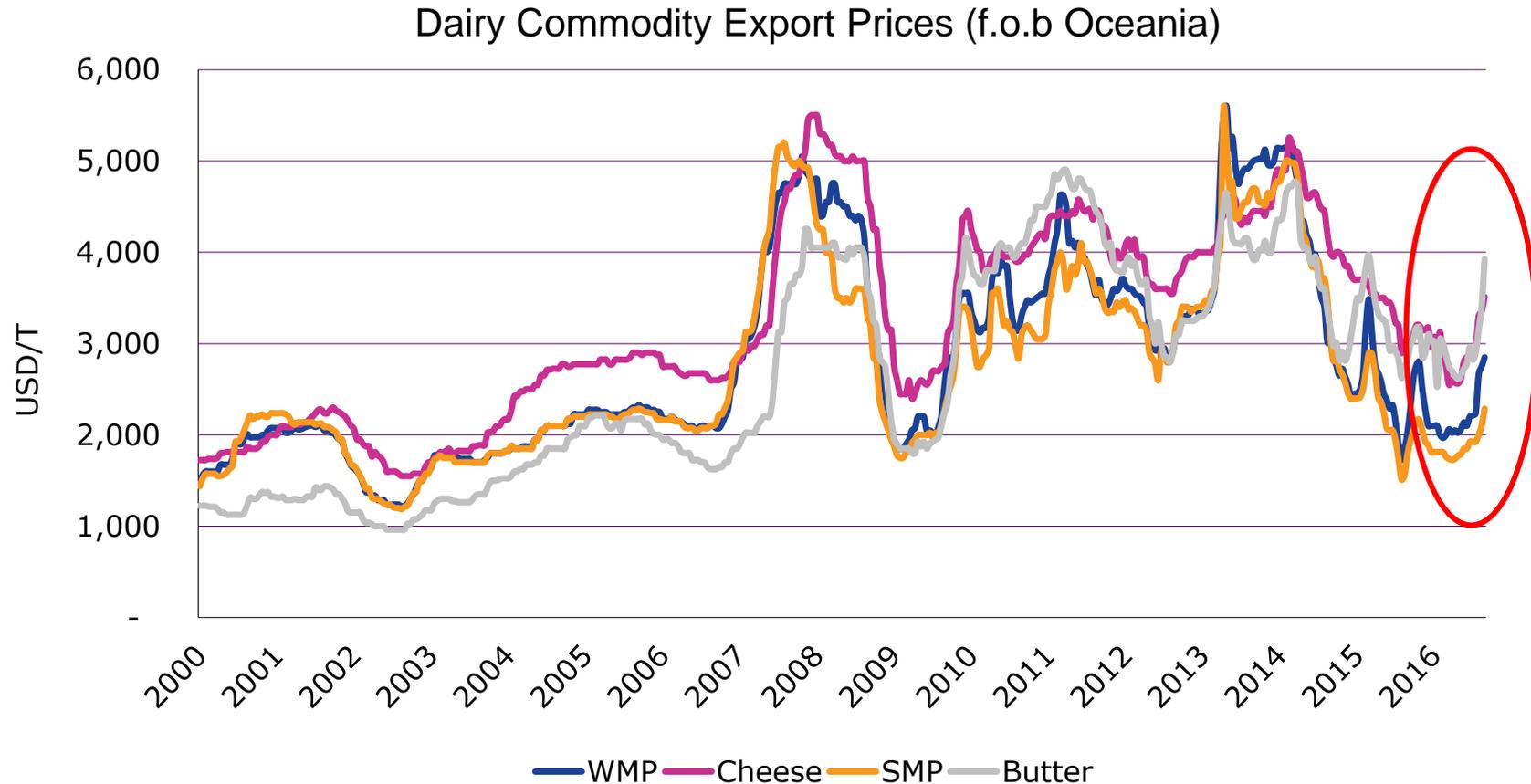
Upward pressure on prices – ‘ladders’

Section 5

Price forecasts and alternative scenarios

Prices have rocketed upwards.

In the last 3 months prices have increased 35%.



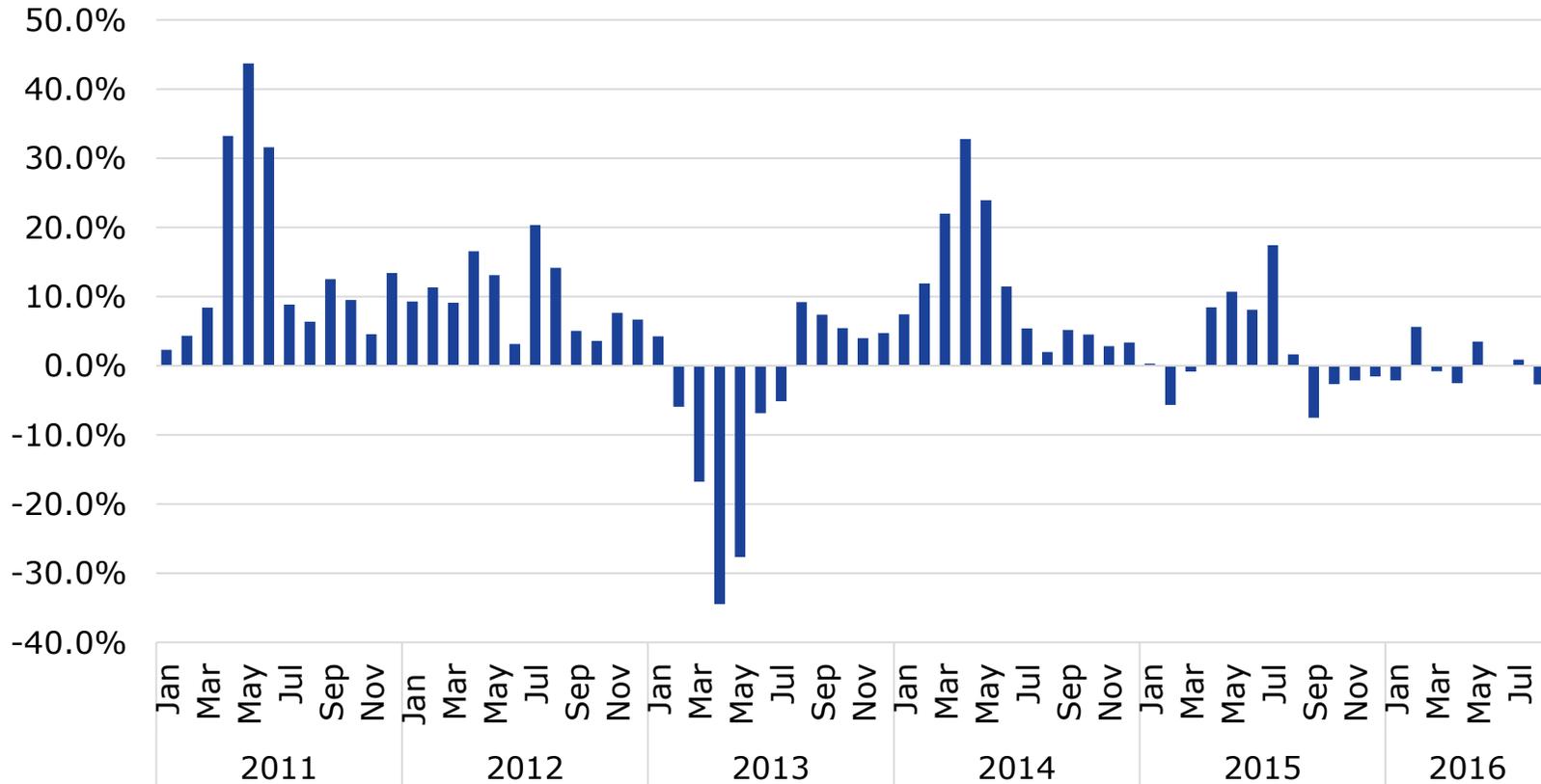
Source: USDA, Rabobank

New Zealand milk supply is now falling.



Tough margins, bad weather, and fewer cows are biting into NZ supply.

New Zealand annual milk production

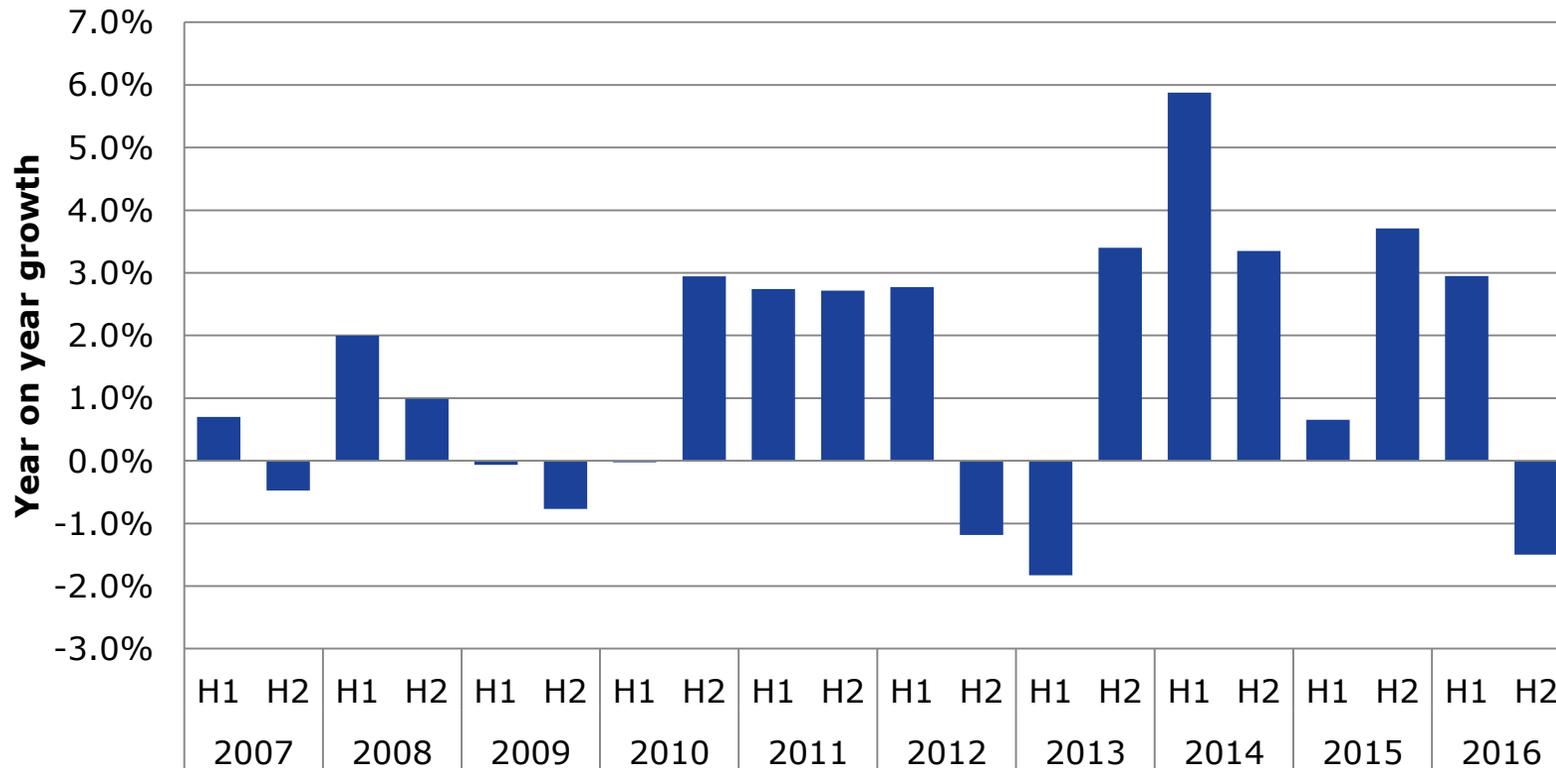


Source: DCANZ, Rabobank

EU milk supply also has taken a hit.

Very low margins and new incentives to draw down supply making an impact.

EU quarterly milk supply growth

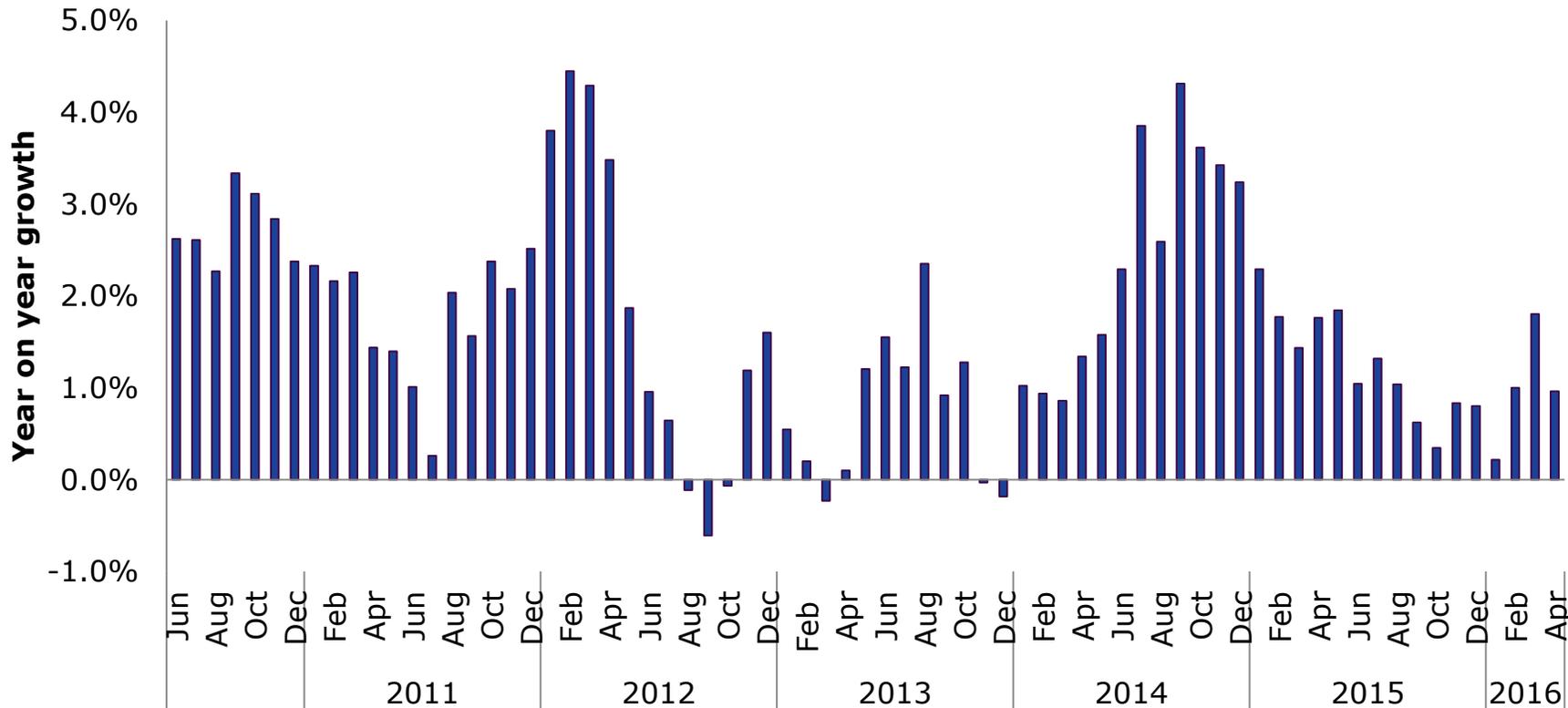


Source: Dairy Australia, Rabobank

US milk supply is still growing.

High prices for butter and cheese and low feed costs have driven growth.

US monthly milk supply growth



Source: Rabobank, USDA

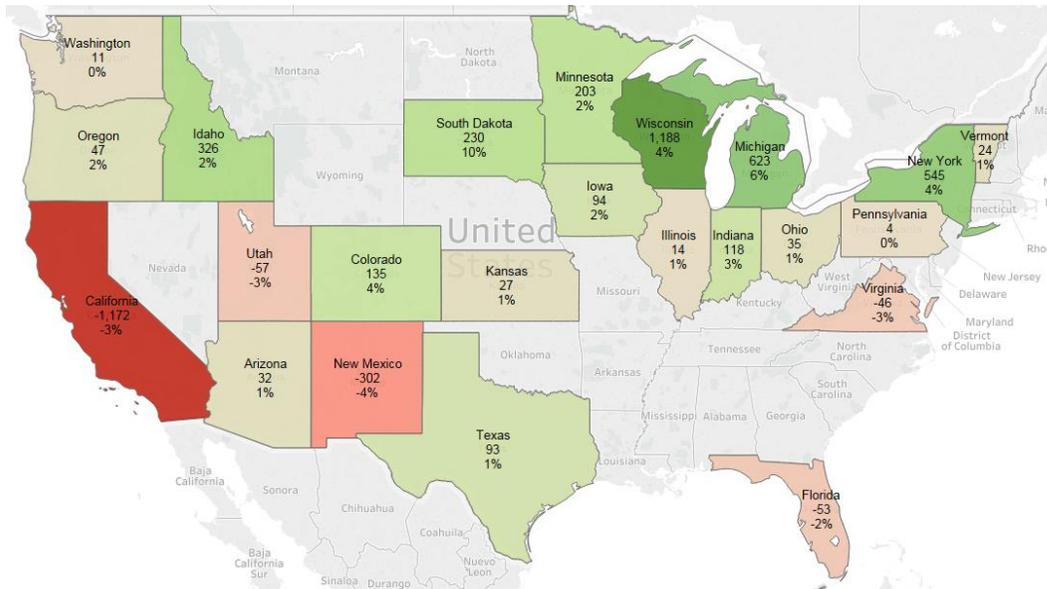
Note: Mar to Jun 2013 breakdown is an est (due to govt shutdown)

Growth is slowly moving back east.



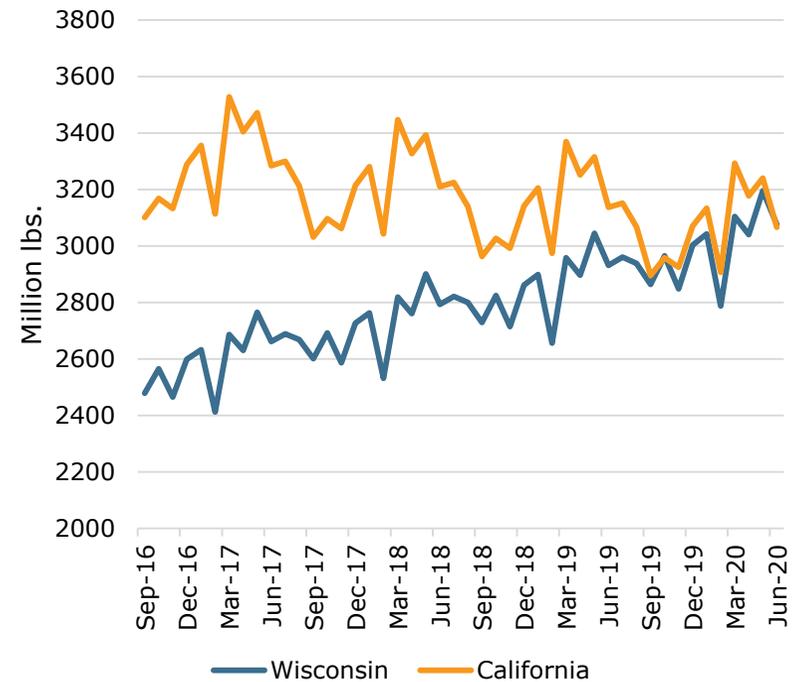
At current trajectory, Wisconsin will become the US' largest producer by Oct 2019.

US milk supply growth 3 months to Aug 2016.



Source: Rabobank, USDA

Cali vs. Wisconsin

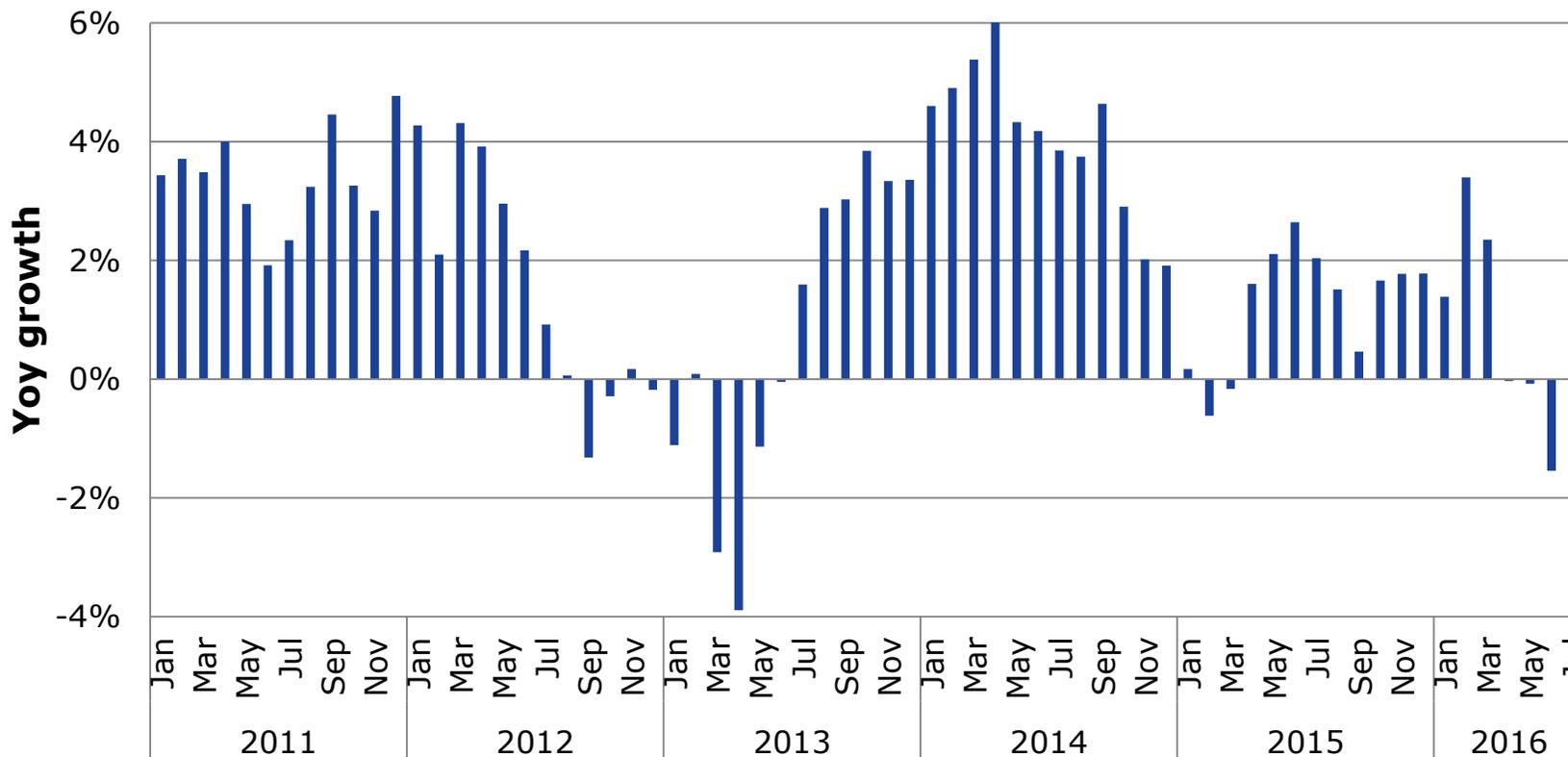


Source: Rabobank, USDA

Milk supply from the big exporters is falling.

The bottom line, global supply is shrinking.

Big 6 milk supply growth

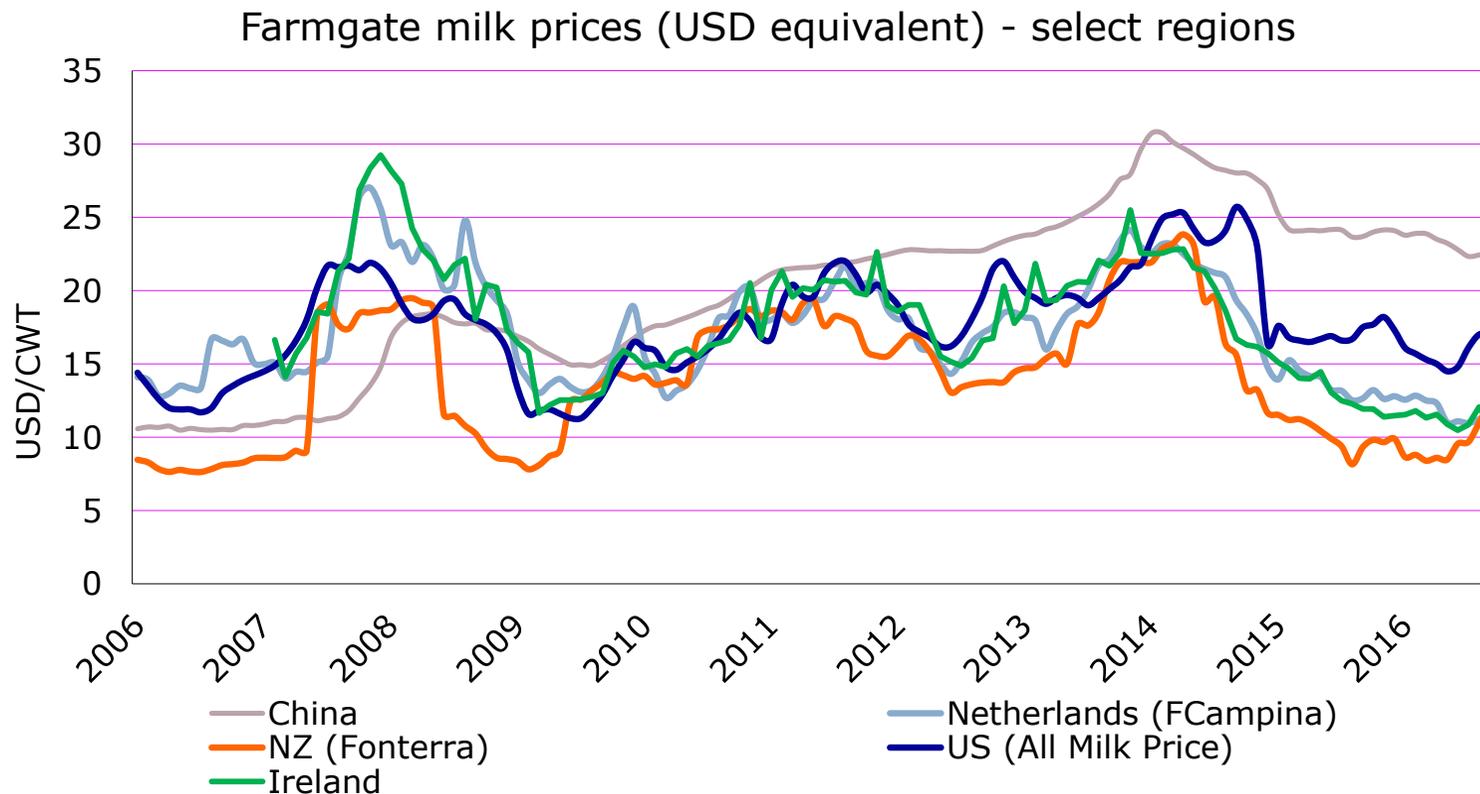


Source: Rabobank

Note: includes EU 27, USA, NZ, Australia, Brazil, Argentina, and Uruguay

Most farmgate prices have moved up.

Farmer margins are starting to look a little better.



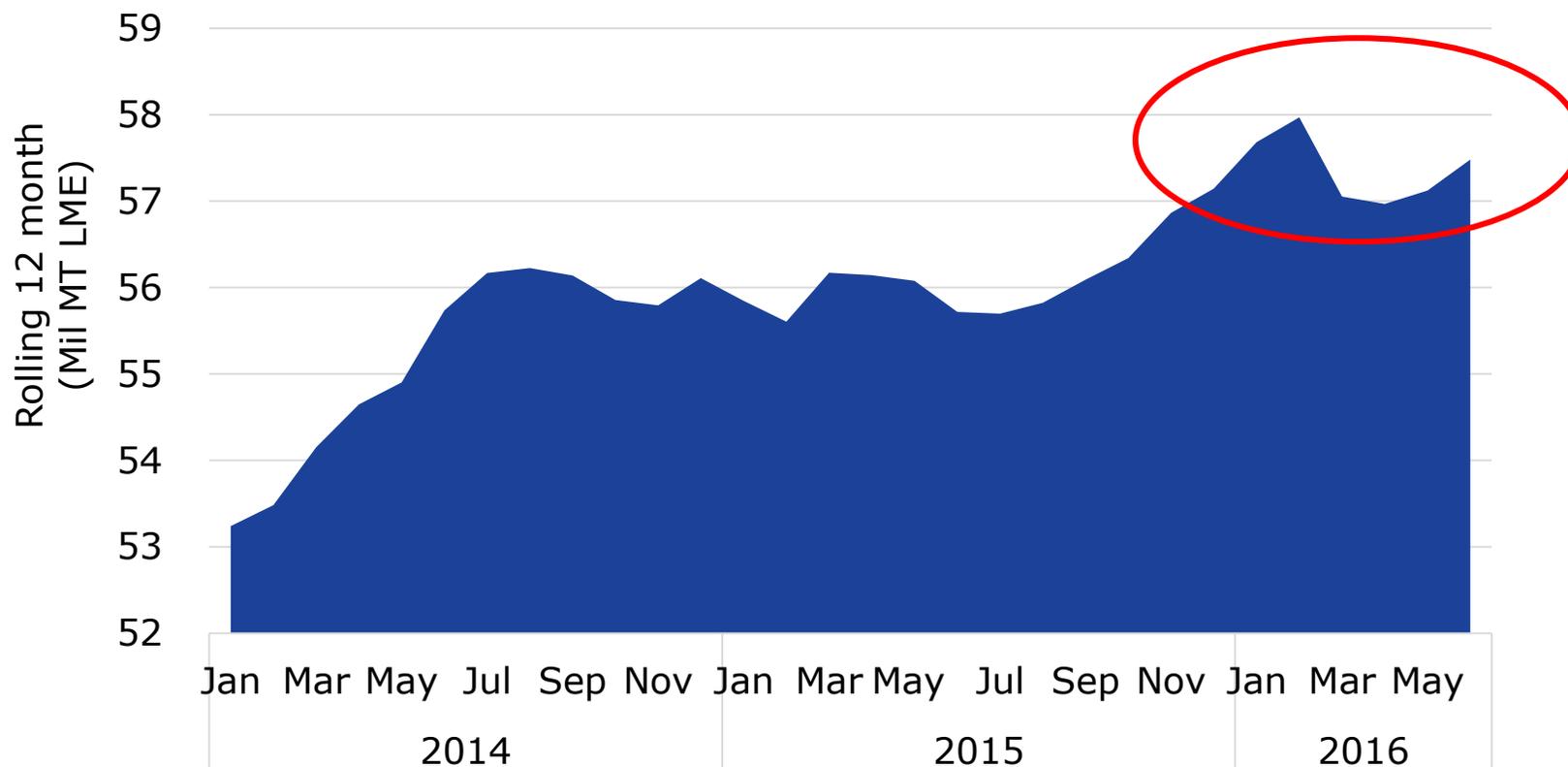
Source: Rabobank

We have passed the import hump.

Global import demand is looking healthy again.



Exports from the Big 6



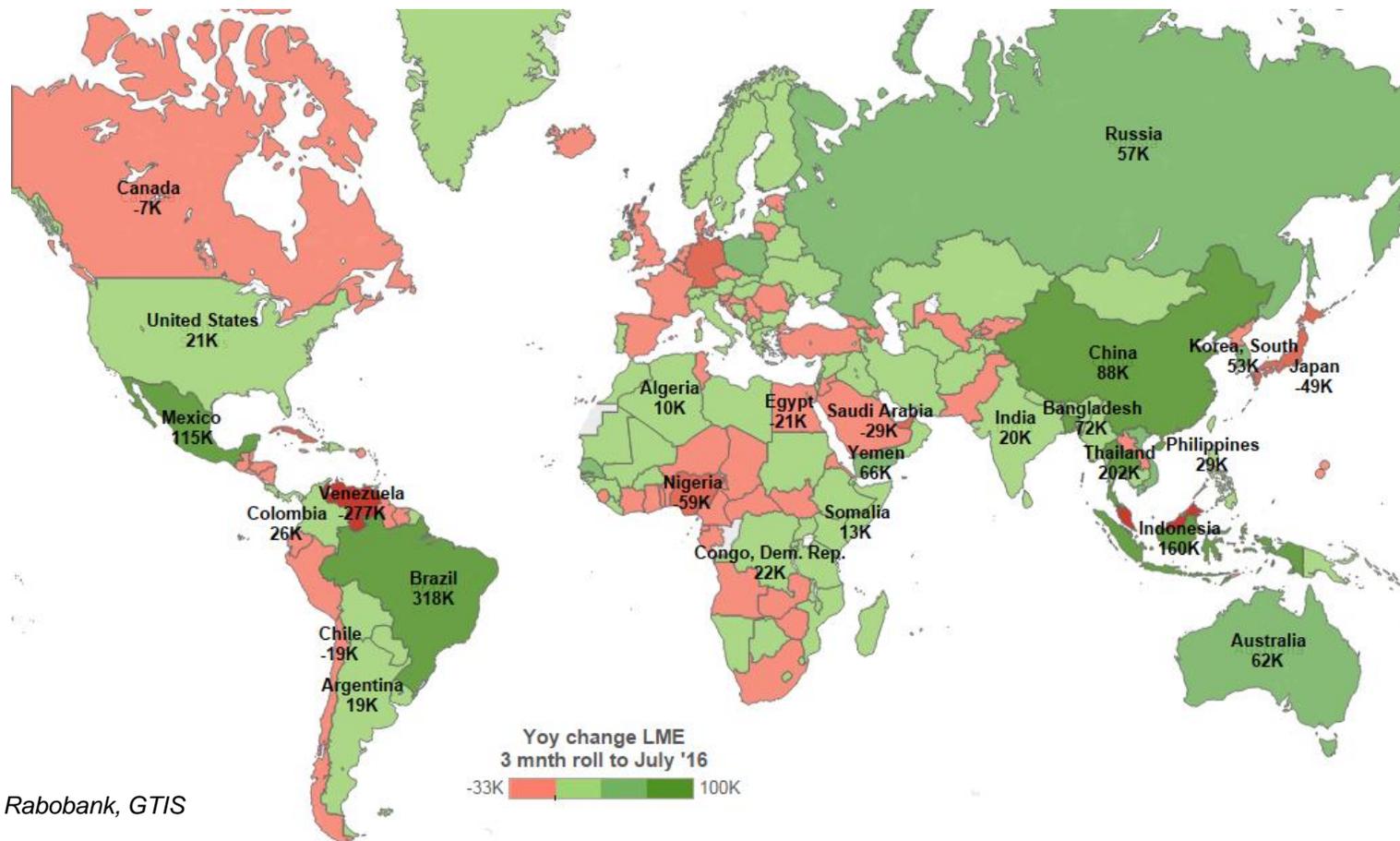
Source: Rabobank, GTIS



Global import growth is diverse.

A diverse list of markets have shown solid import growth.

Global import growth – 3 months to July



Source: Rabobank, GTIS



Inventories remain heavy.

Estimated excess stocks in select regions 6,700k tonnes of LME equivalent.



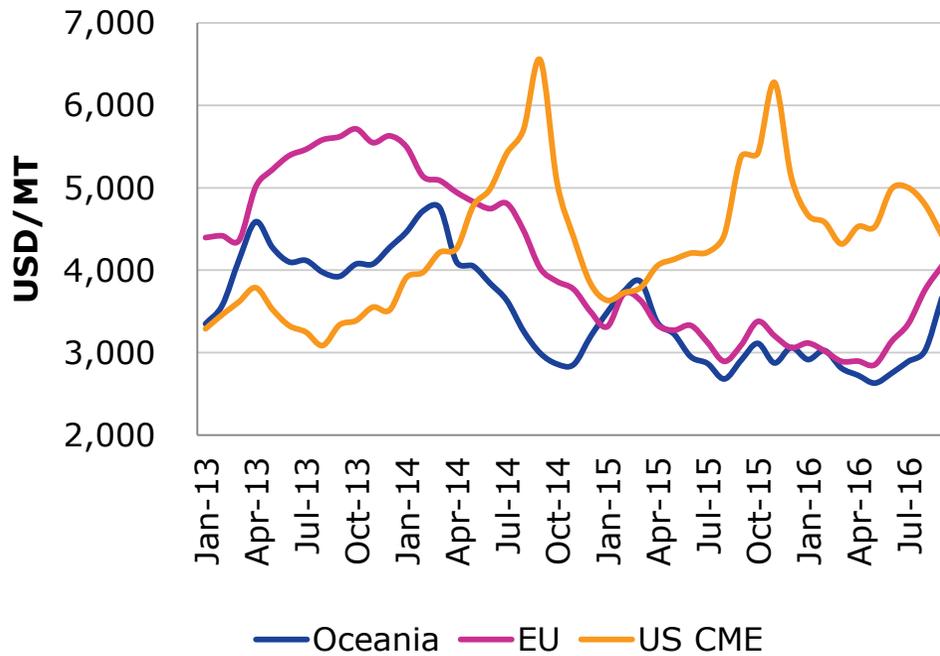
Source: Rabobank

US has realigned with international prices.

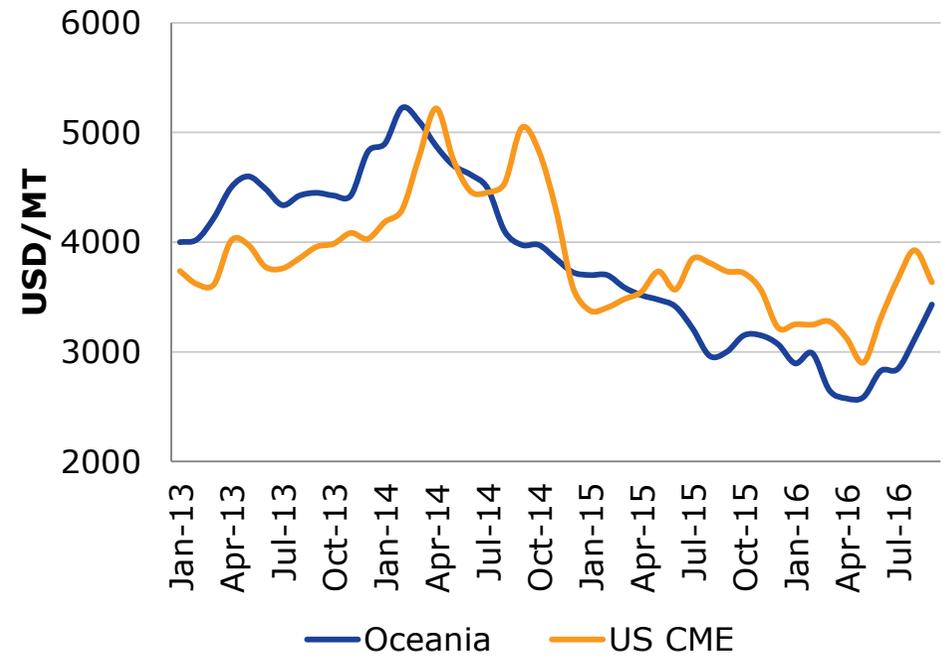


Stocks for cheese and butter are weighing on domestic prices.

Butter Markets



Cheese Markets

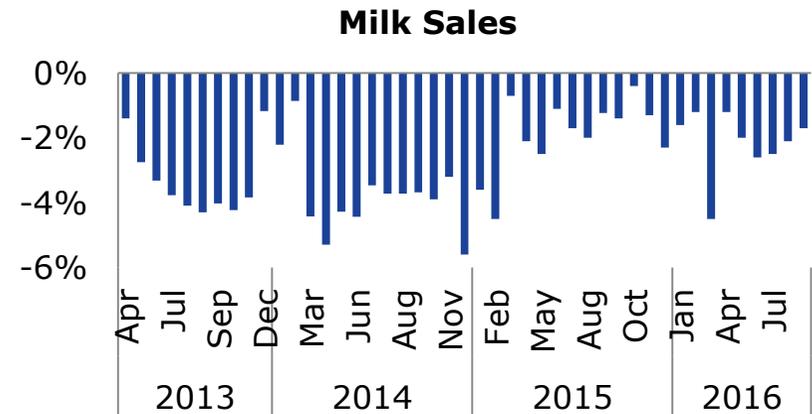
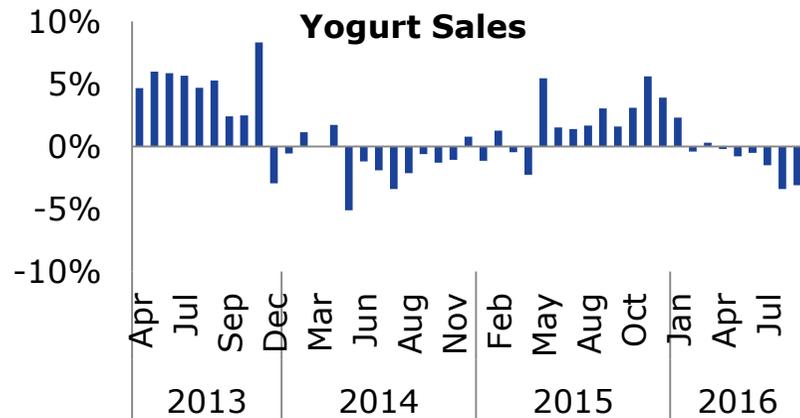
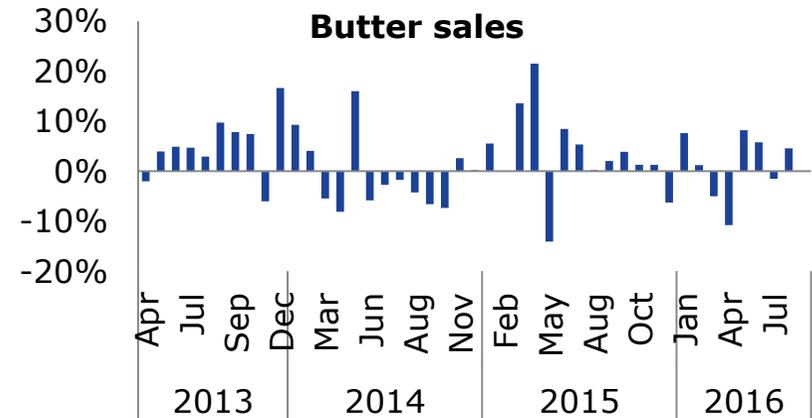
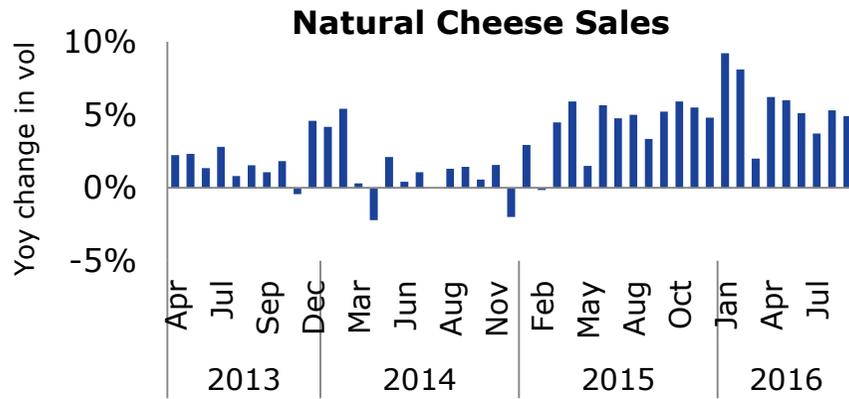


Source: Rabobank, USDA

US retail demand continues to grow.

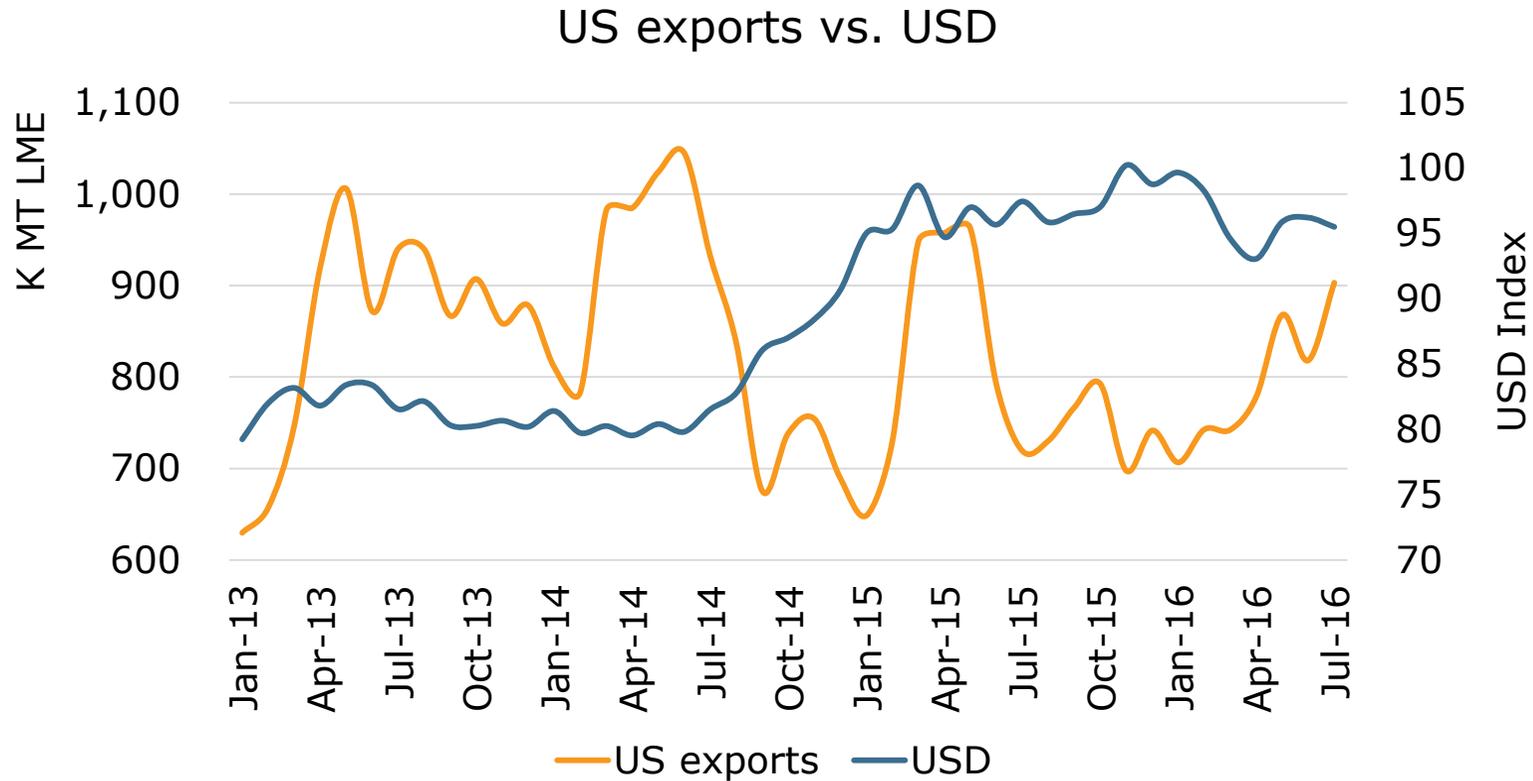


Commercial disappearance was up 2.6% through 1H 2016.



Source: IRI

US exports are picking back up, despite USD.



Source: Rabobank, GTIS, OANDA

Summary of current market status.

- 1 6/7 export markets' supply contracting.
 - 2 Significant inventory overhang remains.
 - 3 Developed market demand growing.
 - 4 US prices have realigned with the world.
 - 5 China back in the market.
 - 6 Buyers are shrugging the strong USD.
-

Section 1 *Current market status*

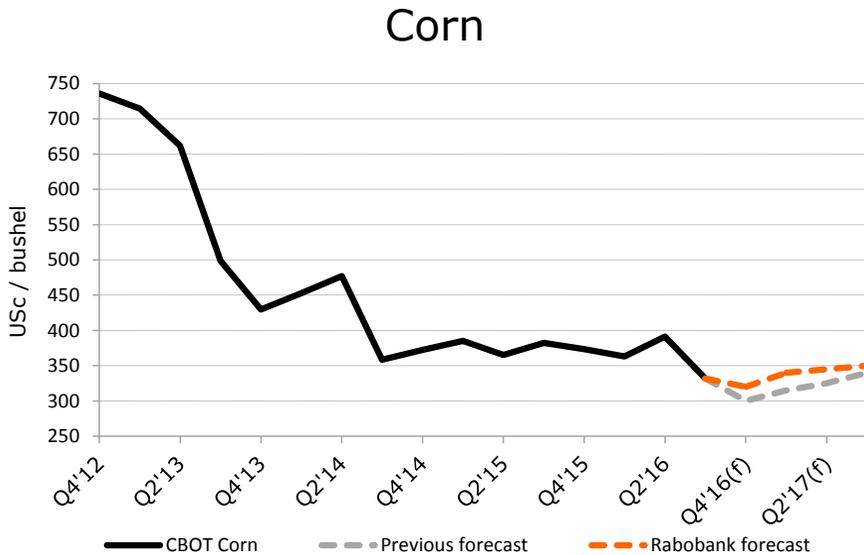
Section 2 ***Downward price pressure – ‘chutes’***

Section 4 *Upward pressure on prices – ‘ladders’*

Section 5 *Price forecasts and alternative scenarios*

Low feed prices helping boost milk supply.

Prices to remain low, keeping US dairy margins manageable.



Source: Rabobank

MISSOURIAN

72°
Scattered Clouds

Search

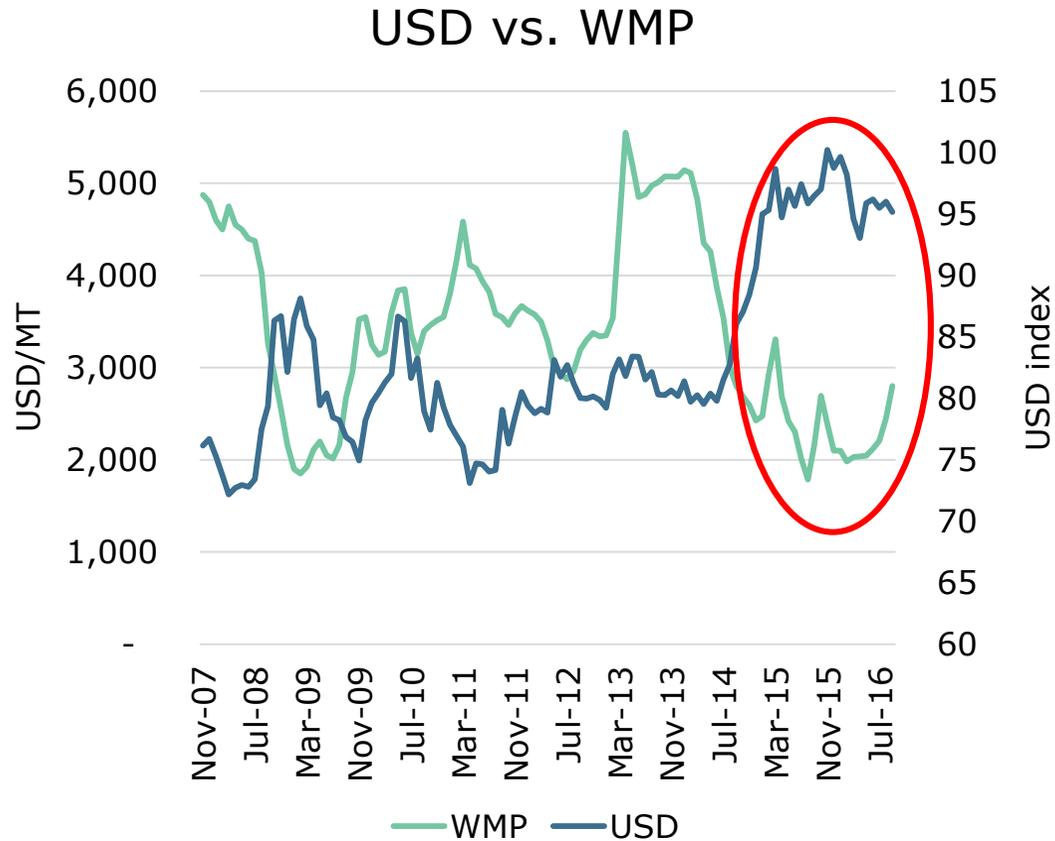
FEATURED

Second-best corn harvest on record underway in Missouri



Strong USD to keep pressure on prices.

Affordability will be a major factor for many developing markets moving forward.



Source: Rabobank & OANDA

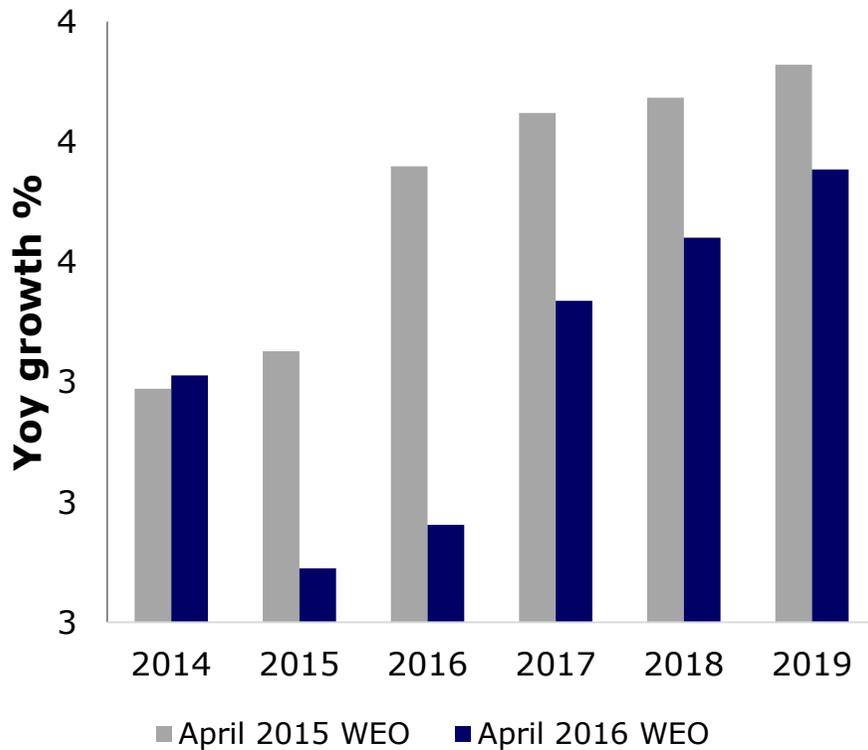


The global economy is still a little 'wobbly'.

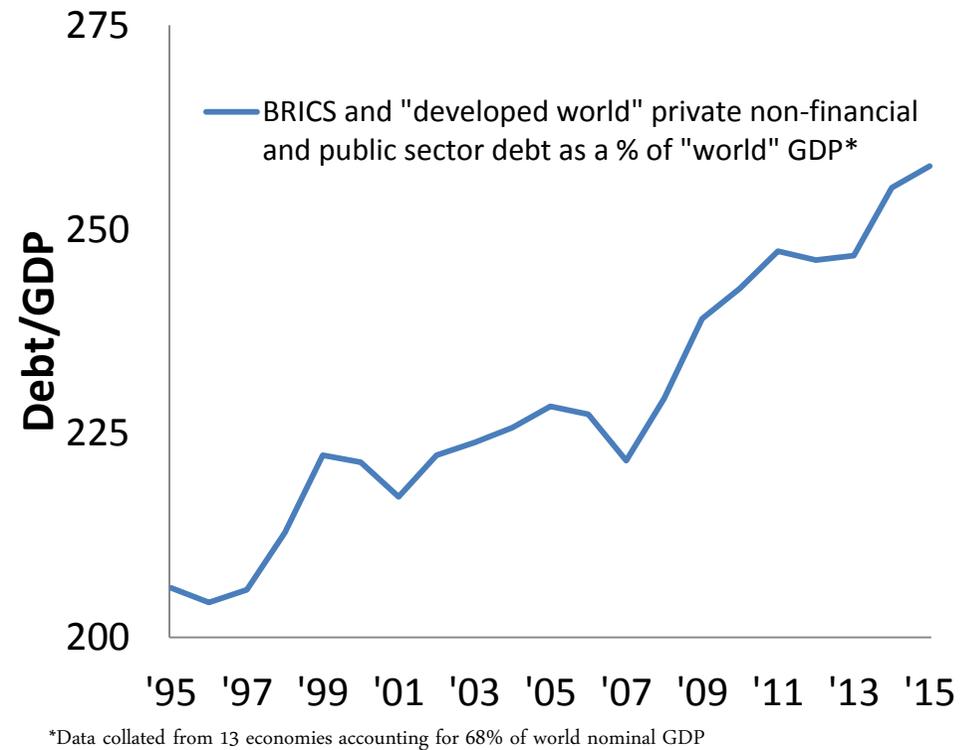


Continual GDP growth downgrades and rising debt a big concern for economists.

Global Economic Growth Forecasts (WEO)



Worrying Debt Levels



Source: Rabobank & WEO

Buyers know the market is still long milk.

Estimated excess stocks in select regions 6,700k tonnes of LME equivalent.

High stock levels.



Makes higher prices a tough argument.

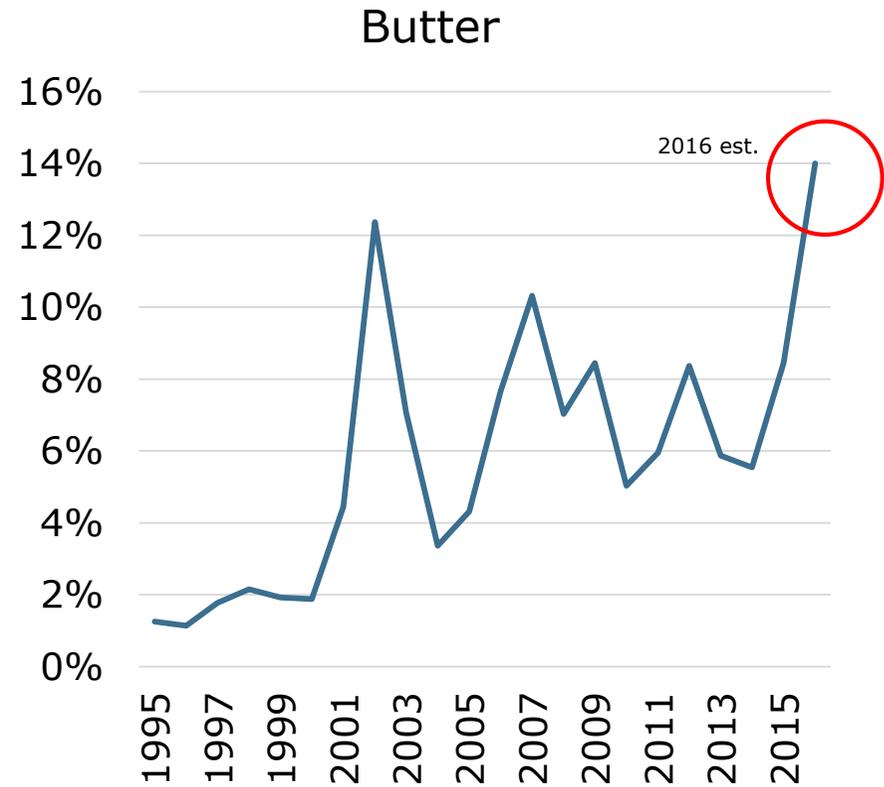
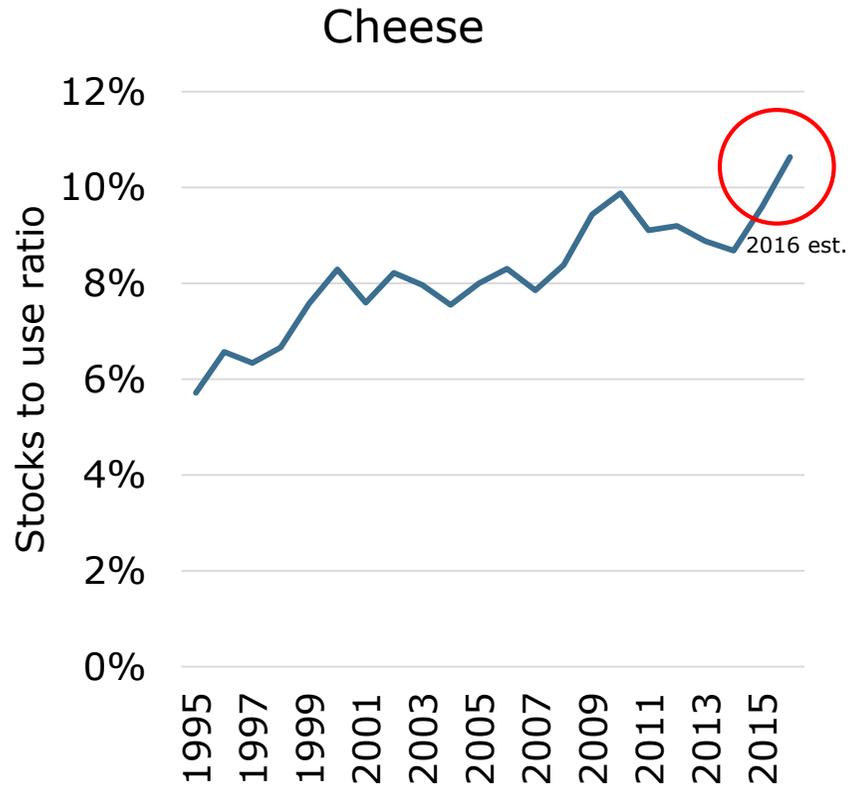


Source: Rabobank

US cheese and butter stocks a little too high.



High inventories in the US will mean discounting and promotions to clear product.



Source: Rabobank & USDA

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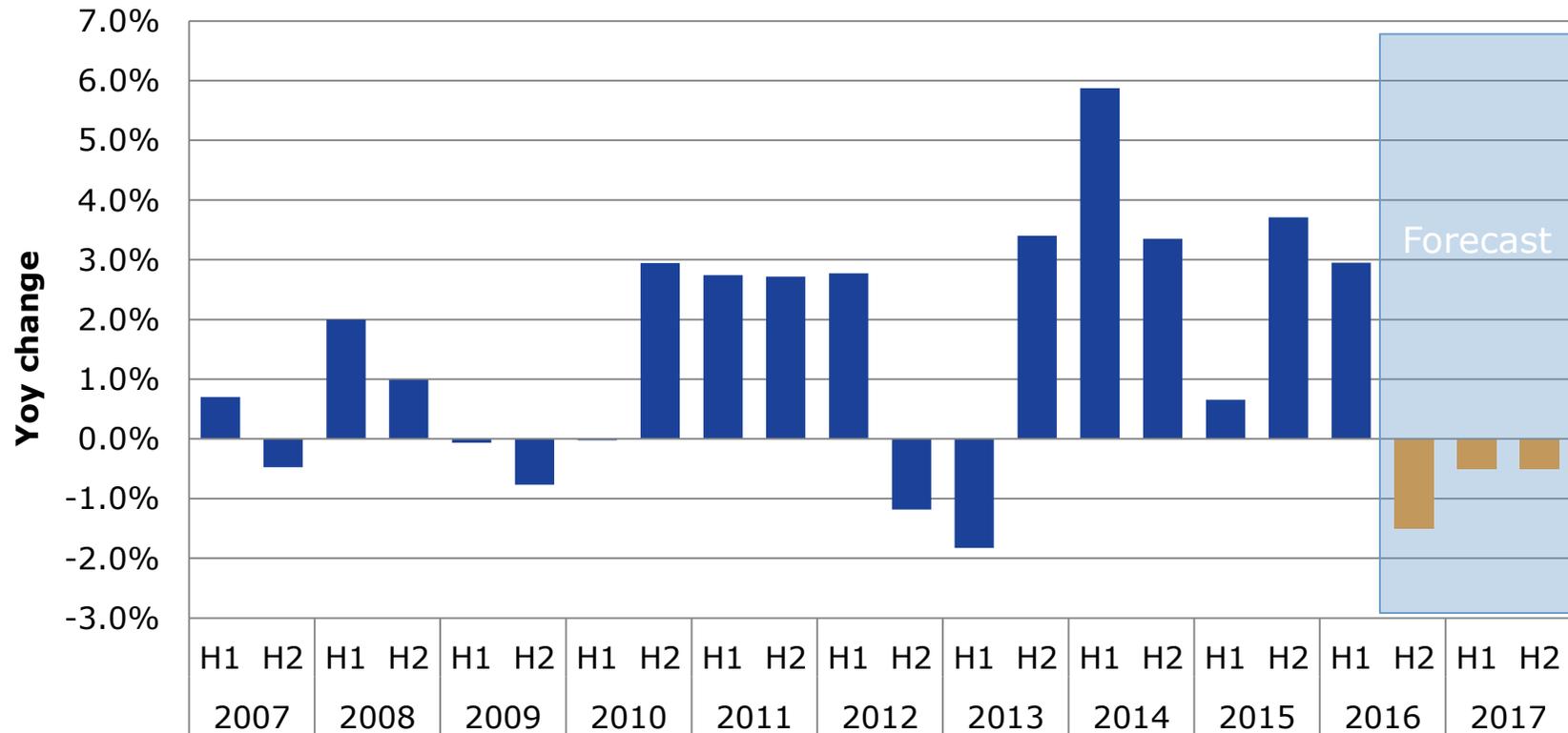
Section 4 ***Upward pressure on prices – ‘ladders’***

Section 5 *Price forecasts and alternative scenarios*

EU milk production will continue to contract.

The biggest part of the recovery is the rapid decline in EU supply.

EU Milk Production Growth

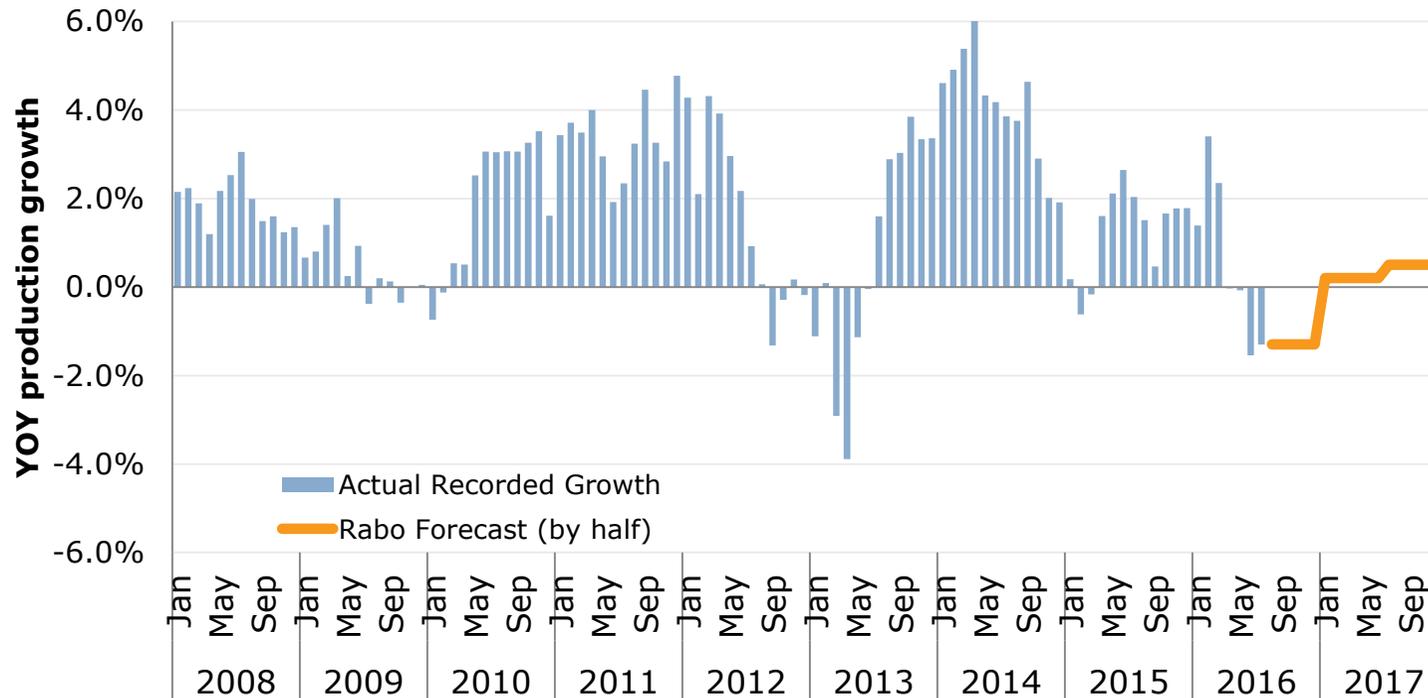


Source: EU commission, Rabobank

Production growth to continue slowing.

We have another 6 months of supply contraction ahead of us.

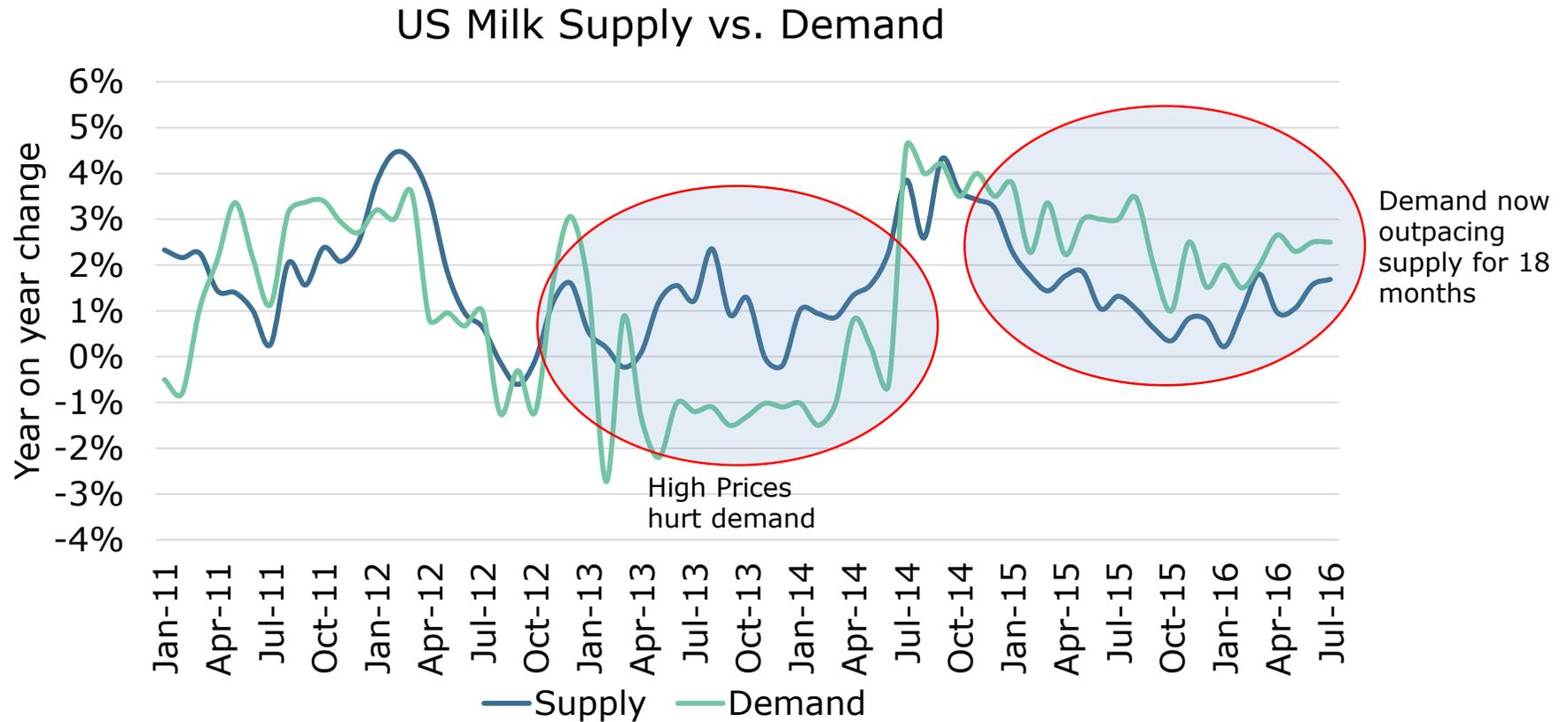
Milk production growth of Big 7 exporters combined



Source: Rabobank

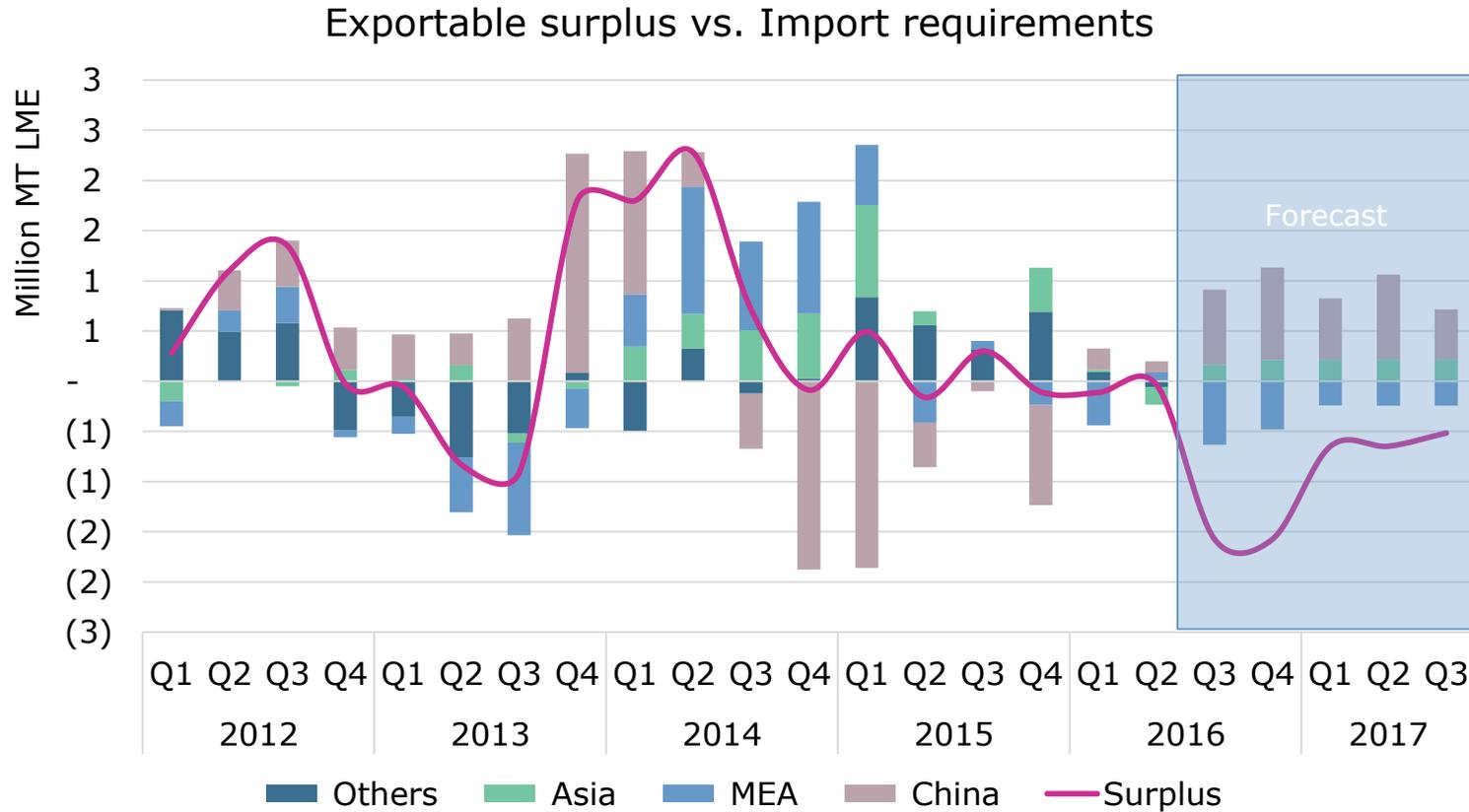
Note: includes EU 27, USA, NZ, Australia, Brazil, Argentina, and Uruguay

But US supply not keeping up with demand.



Source: Rabobank & USDA

Market will remain under pressure.



Source: Rabobank

Government Intervention.

It is unclear how effective the proposed measures will be.

EU Supply Reduction

- *Effective dates, Oct 2016 – Mar 2017.*
- *150 m EUR to be spent paying premiums to farms who reduce supply.*
- *Could theoretically remove 1 billion liters from the market.*
- *Some markets will match the buy back prices.*

California FMMO Litigation

- *Will California be brought under the FMMO?*
- *Proposal to be announced late 2016/ early 2017.*
- *Then farmers provide feedback.*
- *The objective is to raise farmgate milk prices in Cali.*

US Cheese Buy Backs

- *US allocated \$20 million to purchase cheese.*
- *The purpose is to support the milk prices for farmers.*
- *The \$20 can only buy 5k MT of product – less than 1% of US production.*
- *Unlikely to be effective – but signals a renewed willingness of the US government to intervene in price support.*



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Section 5 *Price forecasts and conclusion*



Rabobank dairy price forecasts: FOB Oceania

		Q2 - 2016	Q3 - 2016e	Q4 - 2016f	Q1 - 2017f	Q2 - 2017f	Q3 - 2017f
World (fob Oceania)							
WMP	USD/tonne	\$ 2,067	2,485	3,200	3,200	3,200	3,300
SMP	USD/tonne	\$ 1,788	2,027	2,400	2,400	2,500	2,800
Butter	USD/tonne	\$ 2,702	3,194	3,950	3,900	3,850	3,800
Cheese	USD/tonne	\$ 2,663	3,131	3,500	3,550	3,600	3,700
SWP	USD/tonne	\$ 633	785	800	900	1,000	1,000

WMP prices fob Oceania: Historic and Rabo forecasts

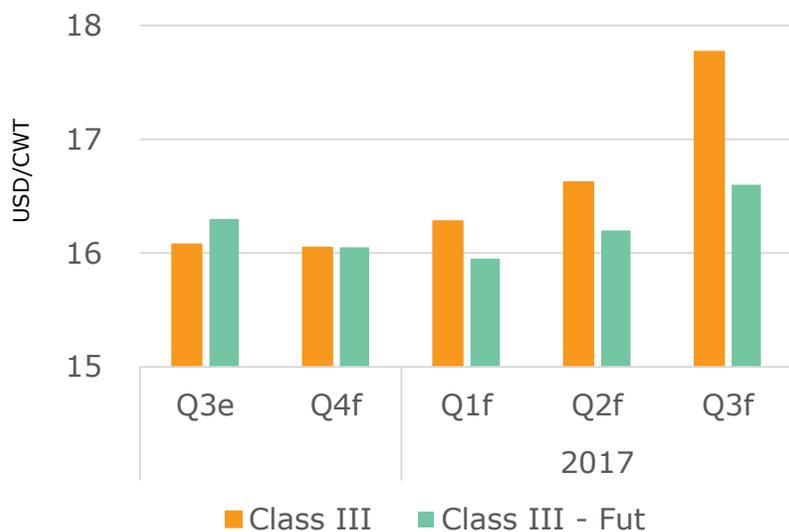


Source: Rabobank & USDA

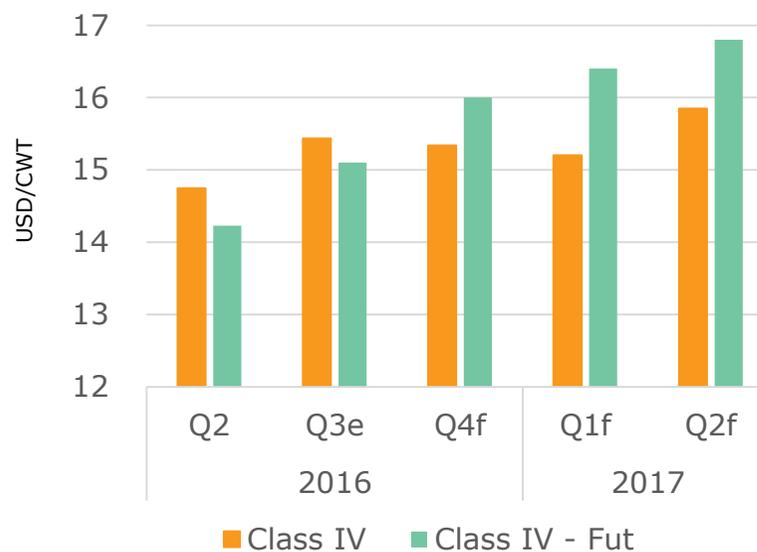
Rabobank dairy price forecasts: US Wholesale

		Q2 - 2016	Q3 - 2016e	Q4 - 2016f	Q1 - 2017f	Q2 - 2017f	Q3 - 2017f
US (AMS announced)							
NFDM	USD/lb	0.76	0.85	1.09	1.09	1.09	1.15
AA Butter	USD/lb	2.08	2.23	1.94	1.92	1.90	1.92
Block Cheddar	USD/lb	1.43	1.69	1.67	1.66	1.68	1.78
Whey Powder	USD/lb	0.25	0.28	0.36	0.41	0.42	0.45
Class III Milk	USD/cwt.	13.20	16.08	16.05	16.28	16.62	17.77
Class IV Milk	USD/cwt.	13.18	14.75	15.44	15.34	15.20	15.85

Class III: Rabo Forecast V CME Curve



Class IV: Rabo Forecast V CME Curve



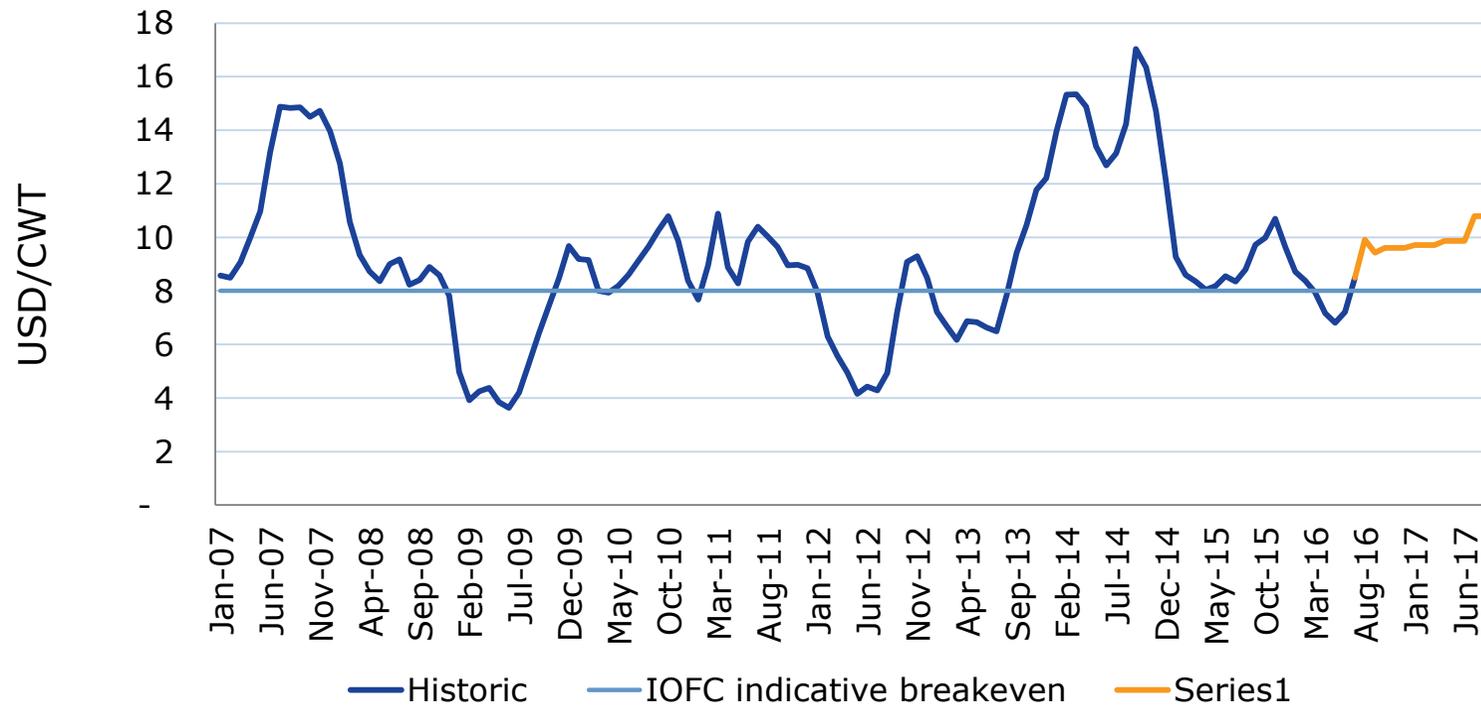
Source: Rabobank, USDA, CME

Producer margins.

An improvement in margins, but still uninspiring.

IOFC Benchmark

Corn and Soy future prices as at Sep 30 2016



Source: Rabobank & USDA

Summary.

While generally improving, the dairy market still has some ups and downs in it.

Chutes

Significant inventory overhang remains.

Global economy is still wobbly.

USD remains strong.



&

Ladders

Massive supply adjustment underway.

Global demand expected to continue to chug along.

US still isn't producing enough milk to meet needs.



Government intervention good or bad, wont move the dial too much.

So what does it mean for dairy in the US

- 1 While profitable, milk prices will remain uninspiring for producers for the next 6-12 months.
- 2 More consolidation of US dairy farmers looking for margins.
- 3 The move back east. Producers and processors.
- 4 Constant volatility in the market. More hedging.
- 5 More pressure on government to help farmers.

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